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In the Supreme Court of the United States

OCTOBER TERM, 1953

No. 75

AMERICAN HARDWARE & EQUIPMENT CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 22-24) are not officially reported. The opinion of the Court of Appeals (R. 72-79) is reported at 202 F. 2d 126.

JURISDICTION

The judgment of the Court of Appeals (R. 79) was entered on February 17, 1953. The petition for a writ of certiorari was filed on May 18, 1953. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the decision of the Tax Court that the $1,800 and $1,500 payments made by the taxpayer to the National Tax Equality Association were not deductible from gross income as ordinary and necessary business expenses under Section 23(a)(1)(A) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code and of Treasury Regulations 111 are set forth in the Appendix, *infra,* pp. 10-14.

STATEMENT

Petitioner taxpayer, American Hardware & Equipment Company, sought a redetermination of income tax deficiencies determined against it by the Commissioner for its fiscal years ended June 30, 1947 and 1948. The only issue presented to the Tax Court for decision was whether the sums of $1,800 and $1,500 paid by the taxpayer to the National Tax Equality Association (hereinafter referred to as "NTEA") in those years, respectively, were deductible from its gross income, either under Section 23(a)(1)(A) or Section 23(q)(2) of the Internal Revenue Code. (R. 22.)

The facts found[1] by the Tax Court (R. 22-23) may be summarized as follows:

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[1] The findings were made upon the basis of oral testimony—some of which (R. 1-20) was reproduced in an Appendix to the brief for the taxpayer in the court below, while additional

The taxpayer has been engaged since its incorporation in 1917 in the wholesale hardware business in the states of North Carolina and South Carolina. Prior to and during the taxable years, it was faced with competition from other distributors, one of which was the Farmer's Cooperative Exchange. (R. 22.)

NTEA is a non-profit corporation organized under the laws of Illinois in October, 1943. Its articles of incorporation provide that the objects and purposes for which it was organized are (R. 23):

> * * * to conduct educational, scientific and research activities relative to disparities in federal and state tax statutes and other laws and regulations affecting business, and to disseminate such information to civic organizations and representatives of business affected thereby, to the public and to federal and state governments. The Corporation shall be non-sectarian, non-partisan, and no part of the net earnings, if any, of the Corporation shall inure to the benefit of any private shareholder or individual.

NTEA was first ruled exempt from taxation under Section 101(6), but at its request was later ruled

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portions were reproduced in an Appendix to the brief for the Commissioner (R. 34-46)—and numerous exhibits adduced in evidence by both sides. Because all the exhibits had been ordered transmitted to the court below in their original form, and to avoid any possible confusion in identifying the various exhibits, the Commissioner prepared and printed, as a separate appendix to his brief in the court below, a complete list (R. 47-60) and a brief description of all of the exhibits in the case and of the principal parts thereof, and quoted certain excerpts therefrom.

exempt as a business league under Section 101(7) of the Internal Revenue Code. (R. 23.)

NTEA was organized and primarily operated from its inception, and during the taxable years in question, for the carrying on of propaganda, the ultimate objective being a revision in the tax structure. (R. 23.)

The suggestion that the taxpayer make contributions to the NTEA came from the taxpayer's president, L. D. Nuchols, who was elected a director of NTEA for the years 1947 and 1948 but did not attend any of the directors' meetings. The taxpayers' directors did not adopt any resolution authorizing the contributions made by the taxpayer to NTEA but informally approved the suggestion of its president. (R. 23.)

In its tax returns for the two years in question, the taxpayer claimed as deductions the amounts of $1,800 and $1,500, representing contributions made by it to NTEA. The Commissioner disallowed them on the ground that they did not constitute proper deductions. (R. 22-23.)

After making the foregoing findings of fact, the Tax Court stated (R. 24) that it had recently passed upon the identical question in *Roberts Dairy Co.* v. *Commissioner,* decided October 31, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,271),[2] and that it regarded that case as controlling. The Tax Court therefore held that the amounts of $1,800 and $1,500 paid by taxpayer to NTEA did not constitute proper deductions under either Sec-

[2] Affirmed, *Roberts Dairy Co.* v. *Commissioner,* 195 F. 2d 948 (C.A. 8th), certiorari denied, 344 U.S. 865.

tion 23(a)(1)(A) or 23(q)(2) of the Code (R. 24). The Court of Appeals for the Fourth Circuit affirmed (R. 72-79).

ARGUMENT

The decision below is clearly correct and, substantially, the petition presents no question which was not before this Court in *Roberts Dairy Co.* v. *Commissioner,* No. 319, 1952 Term, certiorari denied, 344 U.S. 865.

1. Section 29.23(q)-1 of Treasury Regulations 111 (Appendix, p. 14, *infra*) provides that—

> Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

In *Textile Mills Corp.* v. *Commissioner,* 314 U.S. 326, an identical provision of an earlier regulation, of long standing, was upheld by this Court, and held applicable to deductions for expenditures claimed under Section 23(a) of the Code (Appendix, p. 10, *infra*) as ordinary and necessary business expenses.

As the court below properly recognized (R. 77-78), the *Textile Mills* decision is clearly controlling here. The Tax Court found (R. 23) that NTEA was organized and operated for the carrying on of propaganda, seeking a revision of the tax laws. The court below, upon the record, upheld (R. 76-77) that finding as "abundantly supported by the evidence." Accordingly, the court below was ob-

viously correct in sustaining the disallowance of the deductions sought as ordinary and necessary expenses under Section 23(a),[3] "since they clearly run afoul of the prohibition * * * of the regulation". *Textile Mills, supra,* p. 337.

2. In substance, the reasons for the granting of the writ urged here are identical to those which were advanced in the petition in *Roberts Dairy Co.* v. *Commissioner,* 195 F. 2d 948, certiorari denied (No. 319, 1952 Term), 344 U.S. 865. In that case the Court of Appeals for the Eighth Circuit had similarly upheld the denial of a deduction of a payment to the very same organization, NTEA.

a. The first reason urged here (Pet. 6-14; cf. *Roberts Dairy* petition, *passim*), to the effect that the decision below is inconsistent with *Textile Mills, supra,* and *Lilly* v. *Commissioner,* 343 U.S. 90, rests upon the contentions: (i) that *Textile Mills* constitutes no more than the approval of the disallowance of a deduction for sums expended for lobbying purposes by a taxpayer in the lobbying business; and (ii) that to be non-deductible under Section 23(a)(1)(A) an expenditure must have been for something sinister, illegal or deeply repugnant to public policy. Neither of the arguments has any merit. As to the first, it seems clear that no such narrow reading of *Textile Mills* is warranted, but even if it were there would be no basis for the

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[3] The taxpayer (cf. R. 24, 73) also sought deductions for the same item as contributions under Section 23(q)(2) of the Code (Appendix, pp. 11-12 *infra*)—which expressly denies deductibility where a "substantial part of the activities" of the donee is "carrying on propaganda, or otherwise attempting, to influence legislation." That contention is abandoned here.

assertion of any inconsistency or conflict with the decision below, inasmuch as both decisions affirmed the disallowance of deductions for this type of expenditure. As to the second, the decision in the instant case, like this Court's decision in *Textile Mills,* rests upon an interpretative regulation which "had itself been in effect many years with congressional acquiescence." *Lilly, supra,* at 95. As there was no such interpretative regulation in *Lilly,* that case did not come "within [the] precedent [of *Textile Mills*]." (*Ibid.*) The same regulation here, still retaining the acquiescence of Congress, has necessarily led to a result similar to that in *Textile Mills.* Indeed, the plain terms of the Regulation have never been limited to preventing only deductions of expenditures for illegal or shady purposes, and nothing in the *Lilly* case, or anywhere else, reveals any reason why they should be so limited now. See *Bellingrath* v. *Commissioner,* 46 B.T.A. 89; cf. *Sunset Scavenger Co.* v. *Commissioner,* 31 B.T.A. 758, 763, reversed, 84 F. 2d 453 (C.A. 9).

b. The second reason advanced by this taxpayer (Pet. 14-20; cf. *Roberts Dairy* Petition, pp. 14-18) is that changes in the applicable statutes and regulations since the *Textile Mills* decision require a different result now. The argument, briefly stated, runs as follows: Subsequent to the taxable years involved in *Textile Mills,* Congress, in what is now Section 23(q)(2) of the Code (Appendix, pp. 11-12, *infra*), made a specific provision for the deduction of charitable contributions by corporations. The old regulation (i.e., the one involved in *Textile Mills*) was divided in two, leaving the relevant por-

tion (Section 29.23(q)-1 of Regulation 111) applicable only—so it is claimed—to deductions sought for charitable contributions under Section 23(q)(2) of the Code. The contention is, in other words, that, as a result of these changes, deductions for expenditures for the promotion of legislation, propaganda, lobbying, etc., sought under Section 23(a)(1)(A) of the Code as business expenses, are no longer specifically prohibited by regulation. This, plainly, is only a repetition of an argument made in *Textile Mills,* which this Court rejected squarely, stating, with reference to the identical provision contained in the old regulation, that the "argument that it was not applicable because it was not specifically incorporated under § 23(a) is frivolous." 314 U.S. at 338. The provision in question, now contained in Section 29.23(q)-1 of the Regulations, is phrased generally, and says that sums like those here in dispute "are not deductible from gross income." The failure to repeat that restriction in a separate section of the Regulations attached to every separate subsection of the Code under which such a deduction might be claimed is of no more weight here than it was in *Textile Mills.*

c. The third reason urged here (Pet. 21-23; cf. *Roberts Dairy* Petition, pp. 10-12) is that the deductibility of expenditures under Section 23(a) should be tested only upon the basis of the purposes and objectives of the taxpayer making the expenditure and seeking the deduction, without regard to the activities or purposes of the donee of the contribution or of the recipient of the particular expenditure. The Tax Court found in this case that

NTEA was organized and operated for the carrying on of propaganda seeking a revision of the tax laws, and that finding was upheld by the court below. The attempt to evade the consequences of that finding by urging that the private purposes of the taxpayer were different from those of the organization to which it gave its funds cannot alter or obscure the fact that, within the prohibition of the provision of the Regulations in question, the funds were "expended for * * * the promotion * * * of legislation * * * [and] the exploitation of propaganda * * *."

3. The only notable variation, insofar as substance is concerned, between the petition in this case and that in *Roberts Dairy* is that in the instant case it is urged as a separate reason (Pet. 23-24) that the *Textile Mills* decision should be modified. There is no merit to this contention, and, there having been no intervening statutory changes of significance, there is presented no valid reason for a re-interpretation of the identical provision of the Regulations today.

Respectfully submitted,

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Special Assistants to the Attorney General.

JULY, 1953.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(B) *Corporate Charitable Contributions.*—No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the

requirement therein that payment must be made within the taxable year.

* * * * *

(q) [as amended by Section 125 of the Revenue Act of 1942, *supra,* and by Section 114 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Charitable and Other Contributions by Corporations.*—In the case of a corporation, contributions of gifts payment of which is made within the taxable year to or for the use of:

* * * * *

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States, or of any State or Territory, or of the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, veteran rehabilitation service, literary, or educational purposes or for the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes), no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the ac-

tivities of which is carrying on propaganda, or otherwise attempting, to influence legislation; or

* * * * *

to an amount which does not exceed 5 per centum of the taxpayer's net income as computed without the benefits of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(a)-13. *Corporate Contributions.* —No deduction is allowable under section 23 (a) for a contribution or gift by a corporation if any part thereof is deductible under section 23(q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 percent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000.

The limitations provided in section 23(a) (1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable

organization within the meaning of section 23(q) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q)) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

* * * * *

SEC. 29.23(q)-1. *Contributions or Gifts by Corporations.*—A corporation may deduct from its gross income contributions or gifts to organizations described in section 23(q) (see section 29.22(b)(4)-1 for definition of "political subdivision"). * * * Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, re-

gardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

* * * * *

☆ U. S. GOVERNMENT PRINTING OFFICE: 1953 243719 97

FILED
SEP 25 1953
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 75

AMERICAN HARDWARE AND EQUIPMENT COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The respondent's brief in opposition makes certain erroneous and confusing statements upon which we would like to comment.

1. The respondent quotes a section of Treasury Regulations 111, section 29.23(q)-1, pertinent to section *23(q)* of the Code, as the provision controlling the question of payments claimed as deductions under section *23(a)*. He then asserts that an "identical provision of an earlier regulation" has been upheld by this Court in *Textile Mills Securi-*

ties Corporation v. *Commissioner*, 314 U. S. 326. In fact, as the petitioner's principal brief[1] has demonstrated, the quoted part of the earlier regulation was, after the *Textile Mills* decision, made applicable exclusively to section 23(q) of the Code.

2. The respondent argues that the effect of statutory changes and corresponding revisions of the Treasury Regulations, made *after* the decision in the *Textile Mills* case, was considered and discussed in the opinion of the Court *in that case*. We need not dwell on why that is not and could not be the fact. This Court, in its decision in the *Textile Mills* case, did not attempt to predict the course of *future* legislation and Treasury interpretations thereof, and did not attempt to decide prospective cases under such prospective laws.

3. Observing that this Court denied a writ of certiorari upon petition of the taxpayer in *Roberts Dairy Co.* v. *Commissioner*, 195 F. 2d 948, certiorari denied, 344 U. S. 865, the respondent seems to assume, and urge, that the denial of the writ in the *Roberts Dairy* case is *stare decisis* and disposes of this petition. While the underlying issue in that case and the instant case is the same, the present record is more adequate and complete, and the arguments presented here are, we believe, more fully developed. Furthermore, the legal status of lobbying activities has been and is being reconsidered by the courts, including this Court, at the present time.

In any event, as this Court has declared many times, "a denial (of certiorari) carries with it no implication whatever, regarding the Court's views on the merits of a case which it has declined to review." *Maryland* v. *Baltimore Radio Show*, 338 U. S. 912, 919. "Matters relevant to the exercise of our certiorari discretion frequently result in denials of the writ without any consideration of the merits." *Wade* v. *Mayo*, 334 U. S. 672, 680.

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[1] Pet. Br., pp. 14-21.

4. In the absence of any provision in section 23(a) of the Code barring deductions for expenditures incurred for lobbying or legislative activities, it is very evident that a disallowance necessarily and ultimately rests upon "public policy" grounds. *Cf. Lilly* v. *Commissioner*, 343 U. S. 90. This is true whether or not Treasury Regulations purport to bar expenditures for lobbying or legislative activities which otherwise constitute ordinary and necessary trade or business expenses. A regulation which does not rest upon statutory language must logically depend upon considerations of policy, and the validity of its application must be examined in the light of such policy. The public policy basis of disallowance is simply more apparent in the absence of pertinent regulations, which we believe is the situation in the instant case.

Recent decisions of the Federal courts have made it plain that not only is legislative activity of the kind involved in the instant case legitimate and respectable, but also Congress may not infringe upon or restrain directly or indirectly the exercise of lobbying and legislative functions. *See U. S.* v. *Harris*, 109 F. Supp. 641; *National Association of Manufacturers* v. *McGrath*, 103 F. Supp. 510. *Cf. Rumely* v. *U. S.*, 197 F. 2d 166, affirmed 73 Sup. Ct. 543. The *Harris* decision, which holds the Federal Regulation of Lobbying Act unconstitutional because it violates rights of free speech and petition guaranteed by the First Amendment, is pending before this Court at the present time. Probable jurisdiction in the *Harris* case was noted by this Court on May 4, 1953, and the case, docketed as No. 32,[2] has been set down for argument on October 19, 1953.

If legislative and lobbying activities are so far protected by law that Congress may not substantially control and regulate their exercise, it seems to us wholly unrealistic to argue that these same activities frustrate sharply defined public policy. On the other hand, if these activities are

[2] This case was docketed as No. 700 for the October Term, 1952.

recognized as legitimate and proper, the underlying basis for denying a deduction falls away entirely.

5. In view of the widespread character and impact of legislative activities in present day society, the importance of the deduction issue presented in the instant case can hardly be overstated in terms of the overall dollar amounts and number of taxpayers involved. The decisions below present a challenge to the propriety of any payment made by any individual or company to any organization, if the organization, with or without the knowledge of the contributor, appears before Congressional committees or publicizes its point of view on legislative matters. These decisions thus put in question the deductibility of contributions or fees to numerous civic organizations, chambers of commerce, business leagues and federations, and trade unions, to mention only some of the organizations and persons affected.

Conclusion

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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